SUBCOMMITTEE ON

NATIONAL PARKS AND PUBLIC LANDS

HOUSE RESOURCES COMMITTEE

OVERSIGHT HEARINGS

MARCH 25, 2003

WRITTEN TESTIMONY

OF

ANDREW N. TODD, CHAIRMAN

NATIONAL PARK HOSPITALITY ASSOCIATION

AND PRESIDENT/CEO, XANTERRA PARKS & RESORTS

MR. CHAIRMAN, I am pleased to have been invited to your important oversight hearing on concessions policy in our National Parks. I hereby submit my written testimony for the record. As Chairman of the Board of Directors of the National Park Hospitality Association ("NPHA"), I represent a membership that is responsible for most of the visitor services provided by the private sector in our National Parks.

I am also President and CEO of Xanterra Parks & Resorts, which operates both large and small commercial enterprises that benefit park visitors. I also have substantial prior experience in real estate investment and finance.

I. Introduction

The primary purpose of our participation in these hearings is to bring the Committee up to date on efforts to reconcile problems that have emerged in the wake of the passage of the National Parks Omnibus Management Act of 1998 (the "1998 Act"). Although generally these relate to the regulations and form contracts that the National Park Service ("NPS") has promulgated that were supposed to be written to interpret and implement the 1998 Act, there are other important issues that deal with the administration of concessions contracts generally that should be brought to your attention and that are identified below.

The regulations (the "Regulations") are embodied in 36 C.F.R. Part 51, and the three separate form contracts that the NPS has drafted (the "Standard Contracts") were adopted by the agency and published in the federal register on May 4, 2000, and July 19, 2000. To our knowledge, one of the Standard Contract forms has formed the basis for each prospectus issued by the NPS under the 1998 Act.

I have previously appeared before this subcommittee on a number of occasions. Most recently, on February 10, 2000, I appeared to protest the published proposals of the NPS that largely resulted in the Regulations and Standard Contracts a few months later. My written testimony to that hearing (as well as the written testimony of another NPHA member, Terry Povah) gives an overview of the history of concessions, the goals and accomplishments of the 1998 Act and the industry's primary objections to the Regulations and Standard Contracts and the reasons for those objections. Although some of that information concerning specific issues is repeated below, I refer any interested members to the written testimony we provided at that previous hearing for a more in depth treatment of the general purposes behind the 1998 Act and the historical background.

It is no secret that the debate leading up to the passage of the 1998 Act was spirited and divisive. For our industry, these debates amounted to nothing less than a battle for the survival of a viable concession program in the parks. Although much of the debate centered on whether concessioners who had faithfully performed under their prior contracts should be entitled to retain the preferential renewal rights they enjoyed under the prior law, many other issues had a potentially devastating impact on the ability of concessioners to earn a reasonable profit on their operations and investments. Some, we felt, would force many prospective bidders for contracts, including incumbents, to examine whether they could undertake the potential risks as a result of bidding on a concession opportunity. These risks could impair their non-

concession businesses, to the extent the NPS sought rights that went beyond the contracts, or could simply arise from the uncertainty associated with ambiguous regulations and contract terms. The result was that the 1998 Act included compromises on many of these issues.

Although Senator Thomas moved a long way toward the position of the prior administration and sponsors of competing legislation in crafting a compromise, the prior administration was not content with the partial victories it won on some issues and crafted the Regulations and Standard Contracts with a view toward imposing restrictions on concession contracts that it had fought for in the debates but had not achieved. The most negotiated trade-off concerned Sen. Thomas' decision to terminate the preferential right of renewal for larger contracts, but preserve (in modified form) the right of the concessioner to receive a modest return on its invested capital by replacing the previous concept of possessory interest with a new valuation formula, called leasehold surrender interest ("LSI"), that was designed to fix the return at cost as adjusted for inflation, thereby decreasing the uncertainty and potential for disputes concerning the valuation of these interests.

As a consequence, there remain many provisions of these important documents that do not honor either the explicit provisions or the intent of the 1998 Act. The NPHA and certain of our members found it necessary to challenge some of these provisions in court, resulting in over 2 years of expensive litigation that culminated in a Supreme Court argument on one issue earlier this month. Although the decisions of the courts so far and certain representations of the NPS made during the proceedings have clarified some of the matters challenged by the NPHA, others matters in dispute were not decided by the courts, either because the courts did not find them "ripe" for review, or because the NPHA did not raise them in the litigation due to their sheer number. Thus, we believe there is much remaining work to do to normalize NPS regulations and contracting procedures with the goals that Congress was trying to achieve in passing the 1998 Act.

That being said, I am happy to report that the NPHA and its members enjoy a much better relationship with the NPS since Fran Mainella has taken her place and built her staff. It has been refreshing for our members to hear that public access to our parks and the provision of quality services to park visitors is again a priority of the NPS and that the NPS again considers its partnership with concessioners as among the most important of its strategic relationships. It is also a hopeful sign that the NPS has chosen to seek out professional consultants (PricewaterhouseCoopers) to help in assessing its business relationships. While the NPS has as impressive staff dedicated to the protection of park resources, many – including members of this subcommittee and the NPS itself – have acknowledged that NPS employees do not have the necessary business and financial backgrounds to adequately deal with the agency's commercial relationships. Although the NPS has been working toward improving its staff in this area, we believe that outsourcing many of these functions will move the agency more quickly along the path to fixing the problem. If we can engage in dialogue with people who have a working understanding of return on investment and the financial markets, and realize that reducing financial incentives in one area necessitates a compensating enhancement of incentives in others, the process has a better chance of succeeding and the parks will benefit. One must remember that each contract is the result of a solicitation process and that bids will reflect the overall returns that the bidders require, which will to a large extent depend on the risks that the contract and the regulations place on the operator. Because of the hundreds of contracts that are in the pipeline, the sooner that these matters can be resolved, the better.

I have been assured by Director Mainella and persons at various other levels of the NPS that they intend to address the problems created by the Regulations and Standard Contract. In that regard, through the auspices of a task force assembled by the National Park Service Concessions Management Advisory Board (the "Board"), there have been two preliminary meetings among various constituencies to identify some of the more-important issues and try to devise a framework for resolving them.

However, although we have agreed to participate in these meetings, in the final analysis, solutions need to be crafted that comply with the law, create certainty among concessioners, reflect standard business practices, encourage the improvement of visitor services (including operations and facilities), increase administrative efficiency, and reduce bureaucracy and wasteful disputes between the government and its contractors. We believe that the top levels of the NPS embrace each of these goals as well.

To the extent that the solutions proposed do not achieve these goals, we will not hesitate to continue to identify failures in the process and seek help from this committee if needed. In that regard, the encouragement of this subcommittee to address these issues promptly and to facilitate legislative fixes where the regulatory and contracting process has failed would be most welcome.

II. Key Challenges

A. As indicated above, several of the issues that were the subject of litigation between NPS and NPHA were not fully resolved by the courts. Accordingly, Director Mainella is working with NPHA and other interested parties to attempt to cooperatively resolve these issues and others of importance. The key areas currently being discussed are: (a) measurement and assignment of leasehold surrender interests; (b) cross-collateralization of concessioner financing arrangements across multiple contracts; (c) NPS oversight of

transactions that affect the ownership of a concession contract or a concessioner; (d) improvement and simplification of the rate approval process; and (e) attempting to devise a long-term strategy on how best to provide services in parks where the economics don't support the existing contract structure.

B. Leasehold Surrender Interests ("LSI"):

1. The key element of these discussions, and that of greatest interest to both NPS and concessioners, is how LSI will be handled under 1998 Act contracts. As you know, LSI was developed to provide the concessioners with investment protection in concession facilities in order to attract bidders to National Park contract opportunities. However, concessioners believe there are several critical areas where changes are necessary. Because all of the provisions of the Regulations relating to LSI are interconnected, we believe that there are edits required to a significant number of those Regulations to conform them to the law (including the matters resolved in the litigation) and improve the administration of concession contracts in this area. Conforming changes would also need to be made to the Standard Contract forms.

The primary LSI-related issues are:

a. Definitions of Capital Improvements, including the 50% rule

1. While certain sections of the Regulations correctly call for Generally Accepted Accounting Principles ("GAAP") to be used as the benchmark to determine whether costs should be accorded LSI treatment, there are provisions in §51.51 that are contrary to GAAP, such as the rejection of building materials for capital improvement eligibility except when initially installed as part of a structure or where the 50% rule is met. Thus, for example, the conversion of a dormitory to guest lodging, though costing millions of dollars, would not necessarily be considered a capital improvement eligible for LSI treatment. In that case, only if the conversion cost represented at least 50% of the pre-conversion value using a replacement cost standard would LSI treatment be accorded to the conversion. This limitation has been termed the "50% Rule". Thus, common – and sorely needed – renovations, rehabilitations, and other capital improvement projects in our National Parks often would not qualify for LSI treatment. Fortunately, the discussions of the task force convened by the Board indicate that both NPS and the concessioners are in agreement that the 50% Rule should be eliminated. NPHA wants to ensure that this change and related changes to Section 51.51 – 51.66 of the Regulations are made in a more permanent manner through modification of the Regulations and Standard Contract language, rather than through a less permanent solution such as a Director's Order, the solution preferred by the NPS. Employing a Director's Order in the face of published regulations that reach an inconsistent result would at best create ambiguity and confusion and at worst be void as being a policy position that is inconsistent with the published regulations. Moreover, a Director's Order can be easily modified by the NPS without notice and comment rulemaking and thus may only be a temporary accommodation. A temporary solution is unacceptable to the NPHA, since our membership could not rely upon it. Although the NPHA acknowledges that modification of the Regulations will entail additional effort and time, it is critical that the published Regulations in the CFR are clear, workable, well-reasoned, and in compliance with the law. Therefore, we are against efforts to solve any of these issues through Director's Orders where they have already been addressed by Regulations.

b. Prevailing cost ceiling

1. The Regulations also purport to restrict the LSI values to "amounts that are no higher than those prevailing in the locality of the project", which is not a requirement of the 1998 Act. This means the NPS could set LSI values on the basis of lower construction costs in metropolitan communities outside the National Parks, even though the cost of construction in remote park areas could be much higher. The litigation established that this limitation only pertains to a comparison with other in-park projects, which of course are already subject to strict regulation by the NPS. Thus the limitation in the Regulations doesn't make sense. Since concessioners have no incentive to "overpay" for a project in the hopes of receiving LSI that will only grow by CPI, this restriction will only serve to impose a needless bureaucratic step for each project and create confusion and disagreement between the parties. It should be eliminated.

c. LSI credit for amounts funded through Reserve Accounts

1. There has been considerable discussion about whether capital improvements, determined in accordance with GAAP but which are funded from reserve accounts established under new contracts to fund key renovation projects, should be accorded LSI treatment. The statute requires that all in-park capital improvements funded by a concessioner be entitled to LSI. The NPS position (evidently supported by its consultant, PricewaterhouseCoopers ("PwC")) is that moneys spent out of reserve accounts should not be entitled to LSI since they should, theoretically at least, be identified in the prospectus as likely to occur during the contract term. We believe PwC's position to be that any dollars invested through a reserve account have been theoretically factored into their financial analysis when modeling the final scenario that goes to bid. To us, that is a different issue than whether the expenditures are entitled to LSI. Under the 1998 Act, capital improvements made by concessioners are entitled to LSI credit without regard to how

concessioner funds may be segregated under the contract. Although a bidder indeed will make projections relating to all recurring and non-recurring expenditures, whether capital in nature or not, to the extent that a contract would attempt to deprive capital investment of LSI credit, the result would be lower bids (or none at all if the contract could not be economically justified as a result). If an investment is funded by concessioners and it qualifies under GAAP as a capital improvement, NPHA believes it should be assigned LSI just like any other investment. We have no objection to the NPS establishing reasonable reserves, but they should be generally limited to repair and maintenance expenditures that are not capitalized under GAAP. In cases where the NPS would also require reserves for capital items, which generally is not a good idea because this would increase financing costs under the contract since they would not result in collateral to the lender, they should be separate from the repair and maintenance reserve.

2. In our on-going discussions, NPS has emphasized that there should only be occasional or isolated instances where an LSI determination needs to occur. On the other hand, NPHA believes these instances will occur on a more routine basis as capital investment generally occurs throughout a contract term. Since a consistent approach across all contracts would be desirable, NPHA believes that a framework should be set up to resolve these instances simply and efficiently. Possibly a recognized accounting firm such as PwC, acting both in a dual role as NPS' asset manager and as an independent financial expert, could serve to confirm that the costs that are capitalized by concessioners under GAAP are in fact entitled to LSI. This could lead to long-term consistency and stability so that both NPS and concessioners would benefit from having a hopefully simple set of procedures that would be used to evaluate these critical on-going decisions for both parties.

C. Cross-collateralization

1. Cross-collateralization means the use of multiple assets or contracts to provide security for a single or separate loans made by a single lender for the purchase or other investment in (or to provide working capital for) those or other assets. It reduces a borrower's financing costs through the more efficient use of assets by allowing a lender to diversify its collateral and reduce its risk.

2. NPHA, NPS, and PwC have had many discussions over the financial benefit to the concession system of allowing concessioners with multiple contracts to finance them through a "bundled" approach, thereby lowering the cost of borrowing to the concessioners. All parties appear to be in agreement that this is desirable. However, although not prohibited by the 1998 Act, NPHA believes that Section 51.87 of the Regulations may prohibit this. NPS has proposed issuing a Director's Order that would clarify that this is permissible, but since the Regulations could override this Order if NPS changed its mind in the future, NPHA believes this should be clarified and memorialized in an amended Regulation.

D. Shareholder Level Transactions

1. This issue is also of critical importance to any concessioner that is part of an affiliated group of companies or that engages in businesses other than National Park concessions.

2. Although, it may be understandable for the NPS to want as broad approval rights as possible over transactions involving changes in ownership of concessioners and their owners, Congress recognized that regulating shareholder behavior would reduce bidding interest and create enormous risks to affiliated organizations. NPS and NPHA have been working to clarify under what conditions approval by NPS is necessary. There is agreement that clarification is advisable and the NPHA is optimistic that the NPS will ultimately agree on a solution that complies with the law. However, NPS again prefers to issue a Director's Order that would provide guidance, whereas the NPHA believes that the Regulations should be amended to remove the sections that exceed the scope of NPS authority under the 1998 Act.

E. Rate Simplification

1. The statute requires that the rate approval process "shall be as prompt and as unburdensome to the concessioner as possible". Some progress is being made in the area, most notably the food service "core menu" concept. This concept provides that a key list of items should be included in a concessioner's menu and reviewed by NPS to ensure that they are priced appropriately. For all other menu offerings, the concessioner would have the flexibility to design the offering and establish a reasonable price. This would allow for more variety and innovation in menus since there would be no administrative overhead outside the core menu requirements.

2. Very preliminary discussions have begun on how this "core" concept might be applied to lodging, but nothing firm has been determined. The NPHA has long argued that the current "comparability" approach employed by the NPS is seriously flawed. If a "core" concept can be implemented that would permit non-core lodging units to better reflect market conditions, both the NPS and concessioners would benefit, and bureaucracy can be virtually eliminated in this contentious area.

3. Discussions are also underway on how retail pricing mechanisms might be improved to streamline this process as well.

F. Unprofitable Concession Contracts and Fee Reductions

1. The NPHA is concerned about the viability of visitor services at some of the smaller parks. Lower visitation, coupled with dramatic increased in operating expenses such as the cost of energy, administrative requirements under our contracts and all forms of insurance, have made many concession operations unprofitable. Normally a concessioner would be able to bid a lower fee upon renewal to compensate for these problems, but this does not provide relief under an existing contract. The contracting backlog has resulted in countless extensions of the old contracts. For example, my company's contract at Stovepipe Wells in Death Valley, California expired in 1985 and is presently still operating on a year-to-year extension. Of course, a concessioner could simply walk away from an unprofitable expired contract, as occurred at Oregon Caves, but then that would leave the NPS in a difficult situation to try and find a temporary operator for an unprofitable concession contract. However, most concessioners are not looking to dissolve the long-term relationships they've established with visitors, their employees, and the NPS. Nonetheless, years of net losses at operations such as Stovepipe Wells, combined with significant Concessioner investment under the pre-1998 Act contracts, even where the Concessioner doesn't have possessory interest in the improvements, has created an untenable situation.

2. The NPHA understands that the contract backlog will not be cleared for some time, and we believe the volume of open RFPs should be maintained at a manageable level. Therefore, in the interim we think it would be in the mutual interest of concessioners and NPS to review the fees paid at parks such as Death Valley, Petrified Forest, Everglades, and other unprofitable parks to determine whether fee relief would be appropriate during the extension period. The involvement of PwC could be very helpful in designing a streamlined process that would be efficient, fair, and consistent.

3. In some cases fee relief alone may not be enough. Appropriated funds are needed to address deferred maintenance at government owned facilities such as Flamingo Lodge in the Everglades. Contractually required concessioner capital (that would be entitled to LSI credit) may be able to address some of the deficiencies at these parks, but the economics of many of these properties may nevertheless produce insufficient returns to attract an operator, even with no fee. In those cases, government appropriations to make necessary improvements may be the only solution, unless private donations could be found.

Thank you for the opportunity to participate in this important hearing.